



## DIVISION OF INSPECTOR GENERAL

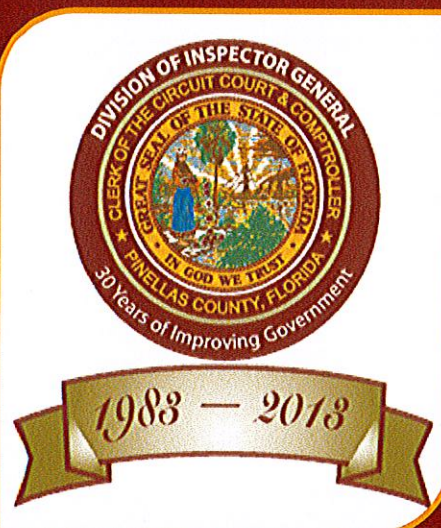
KEN BURKE, CPA

CLERK OF THE CIRCUIT COURT AND COMPTROLLER  
PINELLAS COUNTY, FLORIDA

### INVESTIGATIVE FOLLOW-UP REPORT OF COMMUNITY DEVELOPMENT'S \$3.4 MILLION STATE HOUSING INITIATIVES PARTNERSHIP LOAN TO CREST CAPITAL LLP



An Accredited Office of  
Inspectors General



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JUNE 13, 2013  
REPORT NO. 2013-20





## Ken Burke, CPA


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PINELLAS COUNTY, FLORIDA

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TO: Anthony Jones, Bureau Director  
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FROM: Hector Collazo, Jr., Director   
Division of Inspector General

DIST.: Ken Burke, CPA, Clerk of the Circuit Court and Comptroller  
The Honorable Chairman and Members of the Board of County Commissioners  
Robert LaSala, County Administrator  
Carl Harness, Assistant County Administrator

SUBJECT: Investigative Follow-Up Report of Community Development's \$3.4 Million State  
Housing Initiatives Partnership Loan to Crest Capital LLP

DATE: June 13, 2013

We have conducted an Investigative Follow-Up of Community Development's \$3.4 Million State Housing Initiatives Partnership Loan to Crest Capital LLP. The objectives of our follow-up were to determine the implementation status of our previous recommendations.

Of the 13 recommendations contained in the investigative report, we determined that 10 have been implemented, 2 were not implemented, and one is no longer applicable. The status of each recommendation is presented in this investigative follow-up. We encourage Community Development to implement the remaining recommendations utilizing the County Attorney's legal expertise.

We appreciate the cooperation shown by the staff of Community Development during the course of this follow-up.



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# INTRODUCTION

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## ***Scope and Methodology***

We conducted an Investigative Follow-Up of Community Development's \$3.4 Million State Housing Initiatives Partnership Loan to Crest Capital LLP. The purpose of our follow-up review is to determine the status of previous recommendations for improvement.

The purpose of the original audit was to determine whether allocations noted below were substantiated:

1. The loan transaction was not properly handled by Community Development.
2. The transaction for the sale was questionable with the seller, Terra Excavating Inc.
3. There was a conflict of interest with the County Attorney's Office handling the related court case: Pinellas County vs. Crest Capital LLP.
4. The County Attorney's Office did not properly handle the related court case: Pinellas County vs. Crest Capital LLP (Case Number, 07004938CI).

To determine the current status of our previous recommendations, we surveyed and/or interviewed management to determine the actual actions taken to implement recommendations for improvement. We performed limited testing to verify the process of the recommendations for improvement.

Our investigative follow-up was conducted in accordance with the *Principles and Standards for Offices of Inspector General* and *The Florida Inspectors General Standards Manual* from The Commission for Florida Law Enforcement Accreditation and, accordingly, included such tests of records and other auditing procedures, as we considered necessary in the circumstances. Our follow-up testing was performed during the month of May 2013. The original investigative period was January 11, 2010 through June 15, 2010. However, transactions and processes reviewed were not limited by the investigative period.

## ***Overall Conclusion***

Of the 13 recommendations in the report, we determined that 10 were implemented, 2 were not implemented, and 1 is no longer applicable. We commend management for implementation of most of our recommendations and continue to encourage management to fully implement the remaining recommendations.



# Status

OFI NO.	PREVIOUS RECOMMENDATION	IMPLEMENTATION STATUS				
		Implemented	Acceptable Alternative	Partially Implemented	Not Implemented	No Longer Applicable
1	<i>There Was Inadequate Due Diligence Performed By The CD Department In The Loan Process For The Crest Capital SHIP Loan Of \$3.4 Million.</i>					
	Management:  A1. Planning and commitment process be put into place based on the type and amount of the loan being granted by CD.	✓				
	A2. A formal evaluation be performed by CD and legal reviewed by the County Attorney's Office prior to the Commitment Letter being sent and the loan closing, related on the ability of the entity to support the project.	✓				
	A3. Project funding commitments should be required prior to the closing of the CD loan. Deviations must be approved by County management outside of the CD management process (i.e., County Administration).	✓				
	B. For these types of loans, prior to the loan closing, a formal evaluation of the parcel's ability to support the project plans be performed using the environmental and/or site condition studies and other documentation available pertaining to the parcel condition.	✓				



Introduction

Investigative Follow – Up of Community Development's \$3.4 Million  
State Housing Initiatives Partnership Loan to Crest Capital LLP

OFI NO.	PREVIOUS RECOMMENDATION	IMPLEMENTATION STATUS				
		Implemented	Acceptable Alternative	Partially Implemented	Not Implemented	No Longer Applicable
	C1. Put in place an approval process based on the dollar amount of the loan requiring review and approval outside of the CD Department.	✓				
	C2. Based on a pre-determined loan value, CD is required to have the County Attorney review the loan closing documentation and be the County legal representation at the loan closing.				✓	
	D1. Prior to the signing of the Developer Agreement, a formal documented meeting should be held to ensure what is considered "project commencement" and a tentative schedule developed to avoid future misunderstandings.				✓	
	D2. Meetings held between the parties be formally documented and retained in the project file.	✓				
	D3.CD formally track and document the performance process (contract compliance monitoring) under the Developer Agreement and take action to ensure the completion of the project.	✓				
	E. When compliance issues are present with compliance to the Developer Agreement, the issues should be formally documented by CD and the County Attorney's Office made part of the process.	✓				
2	<i>The Sale Of The Terra Excavating Property Was Not An "Arm's Length Transaction" And The Sales Price Not Properly Set.</i>					
	Management: A. Develop a process to ensure there is a review of future transactions to determine that they are					✓



Introduction

**Investigative Follow – Up of Community Development's \$3.4 Million  
State Housing Initiatives Partnership Loan to Crest Capital LLP**

OFI NO.	PREVIOUS RECOMMENDATION	IMPLEMENTATION STATUS				
		Implemented	Acceptable Alternative	Partially Implemented	Not Implemented	No Longer Applicable
	considered an "Arm's Length Transaction."					
	<p>B. When the parcel sale price is determined by a Limited Appraisal report using the Sales Comparison Approach, the established contingency stated by the appraiser must be considered in the pricing. In the case of Crest Capital, parcel issues with the site condition have a major impact on the set value of the parcel. Adequate due diligence for a commercial real estate transaction should include:</p> <ul style="list-style-type: none"><li>• Proper evaluation of the property's past history.</li><li>• Environmental assessment for contamination.</li><li>• Structure assessment of the property to support the project.</li><li>• Evaluation that the sale is an "Arm's Length Transaction."</li><li>• The sale value is proper.</li></ul>	✓				
3	<p><b><i>The Crest Capital Loan May Not Be Properly Reported To SHIP.</i></b></p>					
	Management contact the Florida Housing Coalition and ensure that Pinellas County is properly reporting the SHIP Crest Capital loan.	✓				



## Background

The Division of Inspector General (IG) investigation of the allegations has determined:

- 1) The loan transaction was not properly handled by Community Development. Substantiated.
- 2) The transaction for the parcel sale was questionable with the seller, Terra Excavating Inc. Substantiated.
- 3) There was no conflict of interest with the County Attorney's Office handling the related Court case: Pinellas County vs. Crest Capital LLP. Not Substantiated.
  - The County Attorney's Office acts as legal counsel for the department as a normal cause of business as it does for all County departments. When the need to file a Complaint for Judgment Foreclosure on the mortgage (SHIP Loan) arose, the records show information was appropriately presented to the BCC in multiple meetings by the County Attorney's Office beginning in May 2007, in which the Board of County Commissioners (BCC) provided the County Attorney directions in pursuing the case.
- 4) The County Attorney's Office did handle the related Court case: Pinellas County vs. Crest Capital LLP (Case Number 07004938CI). Not Substantiated.
  - Based on the IG's review of the Court case records and information provided by the County Attorney's Office, the case was properly handled. The Crest Capital legal team did everything they could to prevent the foreclosure on the property. The County Attorney's Office handled each roadblock presented by Crest Capital and made timely presentations to the Court. The slow pace of the case seems to be caused by the time allowed by law to take action on the motions and the Court caseload. A Motion for Summary Judgment was granted by the Court on July 16, 2010. "The Plaintiff, PINELLAS, shall recover from Defendant, CREST CAPITAL, LLP the sum of \$3,429,126 with costs of \$3,882.65, making a total of \$3,433,008.65 that shall bear interest at the rate of 14% a year, for which let execution issue forthwith."

The recommendations presented in this report may not be all-inclusive of areas where improvement may be needed. We believe that implementation of the recommendations will strengthen current internal controls.

The Constitution of the State of Florida, Article VIII, Section 1, Counties, establishes the Clerk of the Circuit Court Article V, Judiciary, Section 16, Clerks of the Circuit Courts, outlines the duties of the Clerk. One responsibility establishes the Division of Inspector General, which serves the function of County Auditor. On November 1, 2003, the Clerk approved an anti-fraud policy along with a Fraud Hotline. The Director for the Division of



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Inspector General (IG) has the "primary responsibility for investigations of suspected fraud, waste, and/or abuse as defined in this policy."

The IG Director was contacted on January 14, 2010 by the State Attorney's Office (SAO) based on a similar complaint received by their office on the Crest Capital loan. The SAO and the IG Director determined the IG should conduct its administrative investigative audit, and if their office could be of assistance, to contact them. However, if the IG determines that a criminal violation has occurred they would contact the SAO to determine the next course of action. To date, the investigation has not substantiated any criminal activity.

The Pinellas County Community Development Department is responsible for a variety of housing, neighborhood, and community development programs within the County, administering funds granted by Federal, State, and local governments,

Through contracts with nonprofit organizations, CD offers down payment assistance for lower and moderate-income homebuyers, low interest rate loans for home repairs, rental property improvements, and various housing services. Some housing services are provided by for-profit organizations. Working with residents and cities, CD also plans and implements revitalization and enhancement projects in neighborhoods and Community Redevelopment Districts. In addition, CD administers Neighborhood Enhancement Grants for unincorporated County neighborhoods.

Community Development represents the County as the lead agency in a consortium of unincorporated areas and municipalities within the County. The Consortium's plan is to meet identified housing needs, revitalize distressed neighborhoods, assist persons with special needs, and upgrade blighted areas. Funds are used from the Federal Community Development Block Grant Program, Federal HOME Investment Partnership Program (HOME), the State Housing Initiatives Partnership Program (SHIP), and the Federal Emergency Shelter Grant, as well as from local government.

The Crest Capital loan made by Community Development was closed on October 8, 2004 using SHIP funding. The loan was used to purchase a parcel of land (18.43 acres) from Terra Excavating that would be used to construct an affordable housing project. Construction funding for the Crest Capital Project (also known as the Milmarson Place Development Project) was not part of this loan. The BCC approved rezoning of the parcel on April 27, 2004 and July 13, 2004 to support the affordable housing project.

The Crest Capital LLP court case started on June 22, 2007 by the County filing a complaint for judgment foreclosing the mortgage, and if the proceeds of the sale are insufficient to pay Plaintiff's claims, Pinellas County would also seek entry of a deficiency judgment. The court issued the Final Judgment on July 15, 2010; Plaintiff, PINELLAS, shall recover from Defendant, CREST CAPITAL, LLP, the sum of \$3,429,126 with costs of \$3,882.65, making a total of \$3,433,008.65 that shall bear interest at the rate of 14% a year, for which let execution issue forthwith. The property was sold at a Tax Deed Sale on September 14, 2011 to Green



**Introduction**

**Investigative Follow – Up of Community Development’s \$3.4 Million  
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Energy For North America, LLC. The Pinellas County Government Lien is present on the property.

The SHIP report for September 2011 covering the years 2008-2009, 2009-2010, and 2011-2012 does not report the Crest Capital LLP loan of \$3,429,126 as a SHIP expenditure.

As of March 2012, the Property Appraiser Just/Market Value for the Crest Capital Parcel is \$813,280.

**Aerial View Of The 18.43 Acres Property Purchased From Terra Excavating**





# STATUS OF RECOMMENDATIONS

This section reports our investigative follow-up on actions taken by management on the Recommendations for Improvement in our original investigative report of the XXX. The recommendations contained herein are those of the investigative report, followed by the current status of the recommendations.

## **1. There Was Inadequate Due Diligence Performed By The CD Department In The Loan Process For The Crest Capital SHIP Loan Of \$3.4 Million.**

Based on the IG review of the CD Crest Capital Project file, County Attorney file, and the Crest Capital court case documentation, there was a lack of due diligence performed by CD in the loan process for the Crest Capital SHIP Loan for \$3.4 million.

In the IG's audit of Community Development and the Housing Finance Authority (HFA) Administrative Service Agreement released on August 2, 2010, the audit cited the lack of adequate policies and procedures, and reporting and approval processes have bypassed BCC oversight for actions taken by CD on past and current projects, which is the reoccurring theme in this investigative report.

Due diligence, is a key element for planning and financing of any commercial real estate project, specifically prior to committing the County's limited resources and legally to a project/property. The proper due diligence will assure awareness of material facts relevant to the intended use/disposition of the project/property and will help to mitigate identified risks prior to the County committing its resources.

*Due Diligence: "Such a measure of prudence, activity, or assiduity, as is proper to be expected from, and ordinarily exercised by, a reasonable and prudent [person] under the particular circumstances; not measured by any absolute standard, but depending upon the relative facts of the special case." Black's Law Dictionary: West Publishing Company.*

The "Due Diligence" scope is defined by the lender's objectives for offering the financing for the purchase of the property. The CD use of the SHIP funding was to have the developer build affordable housing in Pinellas County. The developer's objective is to seek to add value by changing the character or use of the property. This change must be accomplished in a cost-effective manner. Since the SHIP funding is being offered as a loan, the ability to repay when the project is completed is a consideration. CD is responsible for establishing an adequate "Due Diligence" process when they are performing a commercial real estate lending function. This "Due Diligence" function is in addition to complying with great funding requirements.



Adequate “Due Diligence” is not an option, but a requirement of the County when using funding indirectly coming from the State taxpayers.

Our review determined the lack of and/or compliance with policies and procedures, reporting, and approval processes bypassed BCC oversight for actions taken by CD, which included the lack of due diligence by CD in processing of the SHIP loan resulting in:

- CD granting a loan for \$3.4 million using SHIP funding without addressing or mitigating major risk areas related to the loan, borrower(s), and their corporate structure; issues related to the property jeopardized the \$26.9 million project leading to the failure of the project.
- Use of the County Attorney's resources related to the court case: Pinellas County vs. Crest Capital LLP filed on May 25, 2007, with the final judgment received July 16, 2010 for \$3,433,008.65 (disposition of the property not finalized by the County).

#### **A. Inadequate Due Diligence For Business Structure And Project Planning**

##### **A1. Issue: Inadequate Evaluation Of Corporate/Business Structures**

The Florida Department of State, Division of Corporations, records showed that Crest Capital was registered as a Limited Liability Partnership (LLP) on October 7, 2004, the day before the purchase of the property from Terra Excavating Inc. and the CD loan closing, which was on October 8, 2004. There appeared to be confusion with the managing partners, Nick Kadaicha and Milmarson Development LLC. The "MGRM" (title not defined by the legal documents) for Milmarson Development is George Farrell and Bruce Richardson. However, the loan closing documentation for Crest Capital was signed by George Farrell under Managing Member as Milmarson Development LLC, general partner. The Crest Capital structure issue was presented by the Plaintiff in the Crest Capital case as a problem, which stated that George Farrell signing documents for Crest Capital and "Managing Member" for Milmarson Development LLC was not authorized to sign for Milmarson Development. Milmarson Place, LLC was not registered with the State of Florida until August 12, 2004, three days after the Commitment Letter was sent by CD (August 9, 2004).

In the October 11, 2007 deposition of CD, Management stated that Milmarson Place, LLC was to be the buyer of the property. The loan documentation shows the buyer was changed just before closing of the loan. This statement is confirmed by a Commitment Letter sent out by CD on August 9, 2004 to Milmarson Place, LLC. The information on the change in buyers was not in the Crest Project file and the reason for the change in purchaser was not documented.

There was no documentation in the CD project files showing that CD conducted any internal evaluation (due diligence) of the corporate/business structures of Crest Capital, Milmarson Place, LLC and/or Terra Excavating Inc. Furthermore, there is no



documentation to support Crest Capital’s ability to complete the project. As the borrower, they lacked the financial resources, and there was no documented project team (architect and builder). The lack of financial resources should have been evident to CD and a concern, especially when Crest Capital asked for and received \$25,845 from CD as a Pre-Development Cost (red flag), which was then added to the original loan amount. Neither the Crest Project file nor the check request documentation (justification of the payment) gave any information on what the funds were used for.

## **A2. Issue: Weak Project Planning To Assure Completion Of The Project**

The Crest Capital Loan transaction lacked adequate prior planning and financial commitments to achieve the objective of providing affordable housing units to the Pinellas County residents. The original Development Agreement was with Terra Excavating Inc. (July 30, 2004) in which the BCC had granted two zoning changes to Terra Excavating, parcel owner based on the planned affordable housing benefit. However, the loan was approved and granted by CD to Crest Capital LLP; Terra Excavating was no longer part of the affordable housing project. The project went from a developer that had assets and staffing experienced in construction to a newly formed entity with no assets and little to no experience in construction. In fact, Terra Excavating Inc. benefitted as the owner of the 18.43 acre parcel by selling it to Crest Capital for \$3,410,000 in the transaction.

The CD Crest Capital Project file had no documentation that showed financing planning/commitment by the parties for the \$26.9 million Crest Capital Project prior and after the SHIP land loan was granted. The land purchase loan was made by CD without funding commitments or even a documented plan for financing the Crest Capital Project.

In the second quarter of 2005, CD was actively involved in trying to help Crest Capital to obtain funding for the Project. No commitments were obtained. The situation highlights the risk CD created for the land loan and overall project by not having funding commitments prior to the closing of the loan. The statement on the CD request for the mortgage loan closing check referenced a larger project of \$29.6 million for Affordable Housing when in fact there was no funding commitment in place for that project other than the CD/SHIP land purchase loan.

Proper due diligence for the Crest Capital Loan should have required prior commitments for project funding as CD had for the Alta Largo project which closed on June 24, 2004; project funding commitments were in place prior to the CD loan closing. The Alta Largo project was completed on June 12, 2007.



## B. Parcel Environmental Analysis And Site Evaluation

### **B1. Issue: CD Had Prior Knowledge That The Site Could Have Environmental Issues That Would/Could Affect The Project And Did Not Take Appropriate Action**

There is no documentation that shows the County Zoning Division, Zoning and Code Enforcement, was requested to perform an updated investigation of the proposed Crest Capital site. However, the Department had on file a copy of a "Limited Soil and Ground Water Assessment Report" from Atlanta Testing & Engineering Inc. dated June 2, 1997, which was requested by CD. The analysis found no major environmental issues, but the report did state that the property has been operated as a construction and debris landfill since approximately 1971, and prior to 1971, the property operated as a sand borrow pit. This information (red flag) should have alerted CD to have an environmental analysis and site evaluation completed prior to loan closing.

### **B2. Issue: No Parcel Environmental Analysis And/Or Site Evaluation Documentation To Support The Planned Buildings/Structures Of The Crest Capital Project**

The CD Crest Capital Project file does not contain an evaluation of the site condition prior to granting or closing the Crest Capital Loan. The parcel condition is a critical factor in the development plans and in setting the parcel value. In the August 6, 2004 Appraisal, by McCormick, Braun & Seaman, in calculating the parcel value, the appraiser used a similar type project as Crest to establish the appraiser’s price for the Crest parcel. If the Crest parcel cannot support the planned project, the parcel value would be set too high. There is no documentation in the CD Crest Capital Project file that states consideration was given requiring Terra Excavating to perform site cleanup as part of the sale of the property to Crest Capital.

The site condition study for the proposed multi-family residential development parcel was not released until three weeks (October 29, 2004) after the closing of the Crest Capital loan (October 8, 2004). The subsurface exploration and foundation design study’s preliminary finding stated:

*“The site has been extensively excavated to obtain fill material and has been backfilled with construction debris for at least three decades. Substantial amounts of such debris were encountered and would present a challenging situation for foundation design. A more detailed investigation would be necessary at the locations of the proposed building structures and other engineered facilities at a later date.”*

To correct the problem, they would need to drill about 2,000 additional foundation supports or construct floating foundations; a major site remediation would be required at an additional estimated cost of up to \$10 million to stabilize the site.



Based on the documented history of the parcel, proper due diligence would have required a detailed environmental and site condition analysis to be performed to establish the feasibility of the project before granting/closing the SHIP Loan.

## C. Loan Approval and Closing Process

### Issue: Weak Oversight For The Loan Approval Process And Loan Closing

The Crest Capital Loan of \$3.4 million was not reviewed and approved by the BCC, or at minimum, reviewed by an independent party such as the County Attorney’s Office with the legal expertise to ensure the documents are in order and in the best interest and protection of the County, prior to the closing of the loan.

The lack of a loan approval process was also noted in the IG’s audit of Community Development and the Housing Finance Authority (HFA) Administrative Service Agreement released on August 2, 2010; the audit cited the lack of adequate policies and procedures, reporting, and approval processes have bypassed BCC oversight for actions taken by CD on past and current projects. The IG recommended that a review and approval process be put into place based on the dollar amount of the loan requiring approval by the BCC.

The CD response to the recommendation stated:

*“Management maintains that it is not appropriate for the Board of County Commissioners to “approve” projects or the “financial concessions” that the IG refers to. An applicant seeking financing is either eligible or not eligible. Implementing the IG’s recommendation has the possibility of introducing favoritism into a political process when the underwriting approval process should be an objective, informed decision made by trained professionals.”*

The IG reiterates that it is appropriate for the BCC to approve projects or financial concessions and the authority to establish the policies for the departments under its control. The Crest Capital Loan was not reviewed and approved by the BCC, and the inadequate due diligence by the department may have been performed knowing that another level of review and approval may have raised additional questions that could have mitigated potential risks.

The County Attorney's Office was not requested by CD to review the loan documentation for the Crest Capital Loan prior to closing. In addition, CD did not request the County Attorney be present at the loan closing as a representative for the County and CD. However, the closing was handled by Johnson, Pope, Boker, Ruppel & Burks who represented Terra Excavating at the October 8, 2004 loan closing.



Proper loan closing procedures, particularly a loan valued at \$3.4 million, would/should require the County Attorney's review and representation of the County/CD for key loan closings.

CD did not have an approved and documented approval process related to the Crest Capital Loan. CD was not able to produce a document outlining the approval levels in the CD Department for key activities in the Crest Capital Loan process. In the CD Audit issued on August 8, 2010, Opportunity for Improvement No. 21, stated:

*"The lack of written policies and procedures for reviewing and approving developers' applications for proposed affordable rental housing development projects could result in CD making decisions that are less than optimal. Projects and/or developers might be selected that pose potential risk of not succeeding, or have other issues of non-compliance that could also result in the requirement that the County must return funds to the funding source after they had already been disbursed for the project by the County. Besides the potential financial risks, bad decisions could adversely impact the affordable rental housing opportunities for low and moderate income tenants, which is the main objective of this program."*

The management response did not correct the internal control risk in the CD policy for the Affordable Rental Housing Development Programs and the same type of issue represents inadequate due diligence for the Crest Capital Loan process.

#### **D. Oversight of the Crest Capital Project**

##### **Issue: Lack Of Project Planning Between Crest Capital And CD**

The Developer Agreement of October 15, 2004 signed by Crest Capital for the use of SHIP (State Housing Initiatives Partnership) funds states, *"The project will commence as expeditiously as possible, but no later than June 1, 2005."* (Note: the Development Agreement dated July 30, 2004 was with Terra Excavating and was binding to Crest Capital with the purchase of the parcel. The parcel would have to be used by Crest Capital for affordable housing development. The Developer Agreement states general requirements such as:

- Marketing plan.
- Final plans and design specifications.
- Building permits.
- Mitigation of any findings identified in an environmental assessment.

There is no record in the Project File that Crest Capital LLP submitted a marketing plan for the Crest Project. Of key importance for Affordable Housing units is the sale price. The pricing must be consistent with the ability of the buyer to obtain mortgage financing



based on the income range stated by SHIP requirements. The targeted affordable housing buyers should be able to obtain a mortgage for the unit bank financing. In addition, the non-affordable units have to be properly priced to support the projected construction cost to obtain project construction financing.

There is no documentation in the Project file that covers what is considered project commencement or a time scheduled for the project. Proper due diligence for the Crest Capital Loan would have provided, at minimum, a tentative time line to meet the project commencement date. These dates are important since there were no prior funding commitments for the project, nor a Crest Capital project team established by Crest Capital for the development, planning, and construction phases of the project.

The CD Crest Capital Project file documentation is extremely weak on documentation supporting the contract compliance monitoring of the Crest Capital Project after the loan was closed. In the Pinellas County vs. Crest Capital LLP case file, several documents stated that many meetings were held with CD and Crest Capital on project issues and requirements. However, CD's project file contained no documentation of these meetings before and after the loan closed related to project issues and the CD/State affordable housing processes.

In the CD Audit issued on August 8, 2010, Opportunity for Improvement No. 21 stated:

*“Community Development management have meetings with the parties for Affordable Rental Housing Development Programs on the programs available and requirements prior to an application being submitted. The meetings are not documented in the loan files creating undue risk for the County loan process. Management’s response to the issue was, documenting all meetings is not an industry standard. As many as 80% of proposals do not result in a file. The more difficult proposals least likely to result in a file tend to involve more meetings. Devoting scarce resources to such intense documentation procedures would detract from meeting program goals. We are unable to find any authoritative source that suggests or requires such a high level of documentation.”*

The management response did not correct the internal control risk in the CD policy for the Affordable Rental Housing Development Programs and represents inadequate due diligence for the process.

There was no record of CD visiting the property and taking pictures of the site, particularly since Terra Excavating was still leasing/using the site and exasperating possible environmental/site condition issues (red flag). Furthermore, Crest Capital claimed that the extension of the short-term lease with Terra Excavating was holding up the project, but there is no signed copy of the Terra Excavating lease in the CD project file. In addition, the project file lacked documentation related to discussions held with



Crest Capital’s compliance with the Developer Agreement and evaluating progress prior to the County Attorney becoming involved with the Court case. At that point, compliance with the Developer Agreement was part of the Court case documentation.

The project file contained the preliminary budget for the Crest Capital Project dated November 18, 2004. However, there was no CD documentation as to why Crest Capital did not follow through on the NDC Construction plan or that CD followed up on the project plans. Proper due diligence for the Crest Capital Project should have covered the preliminary project plan development as part of the contract compliance monitoring of the Developer.

Northside Engineering submitted the "Direct Final Site Plans" for the Crest Capital Project to the County Public Works Permitting Division. On June 24, 2005, the Site Plan Review Committee transmitted a rejection notice and stated there were issues that needed correction. None of these documents or information were in the CD project file. Furthermore, the County Development Review Service Manager did not receive any documents supporting the correction of the issues requested by the committee. This indicated that CD was not part of the proposed site planning process, which is unusual since it is a deliverable item under the Developer Agreement (i.e., "final plans and design specifications"). Contract compliance monitoring should have covered the engineering site plan development as part of the compliance with the Developer Agreement.

In a time line produced by CD for the County Attorney dated December 28, 2006 (contained in the County Attorney file), there were three references to letters from Crest Capital covering their compliance to the Developer Agreement:

- January 20, 2006 letter explaining accomplishments geared toward construction activity to CD Management from Nick Kotaiche and George Farrell, Crest Capital.
- March 1, 2006 letter explaining accomplishments geared toward construction activity to CD Management from Nick Kotaiche and George Farrell, Crest Capital.
- July 21, 2006 letter asserting that Crest Capital LLP is not in default of the Agreement to CD Management from Geoffrey Young, Esq.

There were no copies of the letters in the CD Crest Project file and no documentation showing that CD responded to the letters. There was no information in the CD file how the time line supplied to the County Attorney was developed. However, the County Attorney’s file shows involvement in the Developers Agreement compliance issue with the Crest Capital attorney starting August 23, 2006, relating to the Court case process.



## E. Crest Capital Project Corrective Action

### **Issue: Indications Of Crest Capital Project Problems Were Present Throughout The Process, But Not Adequately Addressed By CD**

The October 11, 2007 deposition of a member of CD Management stated that there were no signs that Crest was not going to develop the property. CD Management also stated:

- *We never got dirt turned.*
- *We never got the site leveled off.*
- *We never got it cleared.*
- *We never got what I call construction/architectural drawings.*
- *We never got a site plan.*
- *We never got permitting.*
- *We never got financing commitments from the first mortgage financing company.*
- *We never got all those tools that are a normal part of a development project that you expect to get in that period of time.*

Based on our analysis of the documents and information, CD lacked the proper due diligence process and contract compliance monitoring process that should have identified all of these red flags and avoided, “*We never got all those tools that are a normal part of a development project that you expect to get in that period of time.*” Adequate internal controls, formal written procedures covering the loan process, contract compliance monitoring processes, and adequate documentation requirements could/should have mitigated and avoided the current situation by not granting/approving the loan.

CD did receive documentation related to the Crest Capital Project that included (red flags):

- Letters from Milmarson Place, LLC on the Crest Capital Project dated September 15, 2004.
- Developer Agreement signed by Crest Capital dated November 15, 2004.
- Environmental study on the parcel dated October 29, 2004.
- Preliminary budget for the Crest Capital Project dated November 18, 2004.
- Meeting held between Crest Capital and CD Management throughout the process.
- "Direct Final Site Plan" reviewed by Public Works Permitting Division June 16, 2005.



CD requested and received "Limited Soil and Ground Water Assessment Report" from Atlanta Testing & Engineering Inc. dated June 2, 1997.

**We recommended management:**

A.

1. Planning and commitment process be put into place based on the type and amount of the loan being granted by CD.
2. A formal evaluation be performed by CD and legal, and reviewed by the County Attorney’s Office prior to the Commitment Letter being sent and the loan closing, related on the ability of the entity to support the project.
3. Project funding commitments should be required prior to the closing of the CD loan. Deviations must be approved by County management outside of the CD management process (i.e., County Administration).

B.

For these types of loans, prior to the loan closing, a formal evaluation of the parcel's ability to support the project plans be performed using the environmental and/or site condition studies and other documentation available pertaining to the parcel condition.

C.

1. Put in place an approval process based on the dollar amount of the loan requiring review and approval outside of the CD Department.
2. Based on a pre-determined loan value, CD is required to have the County Attorney review the loan closing documentation and be the County legal representation at the loan closing.

D.

1. Prior to the signing of the Developer Agreement, a formal documented meeting should be held to ensure what is considered "project commencement," and a tentative schedule developed to avoid future misunderstandings.
2. Meetings held between the parties be formally documented and retained in the project file.
3. CD formally track and document the performance process (contract compliance monitoring) under the Developer Agreement and take action to ensure the completion of the project.

E.

When compliance issues are present with compliance to the Developer Agreement, the issues should be formally documented by CD and the County Attorney’s Office made part of the process.



**Status:**

A.

1. **Implemented.** The Loan Review Committee procedures cover the planning and commitment process. In addition, new department internal procedures support the process.
2. **Implemented.** The Loan Review procedures and new department internal procedures cover the loan evaluation and Commitment Letter process.
3. **Implemented.** The Loan Review Committee functions as an external function outside of the CD management to review and approve loans over an established dollar amount.

B.

**Implemented.** The Project File Check List calls for documents that will evaluate the parcel’s ability to support the project plan prior to loan closing.

C.

1. **Implemented.** The Loan Review Committee procedures establish dollar amounts for loan approval that takes place outside of the CD department management process.
2. **Not Implemented.** CD management disagrees that there is a need for the County Attorney’s Office to be present at the closing and review loan documentation prior to the loan closing.

D.

1. **Not Implemented.** CD Management did not see the need to have a formal written procedure to cover documenting meetings for project commencement requirements/schedule.
2. **Implemented.** CD internal procedure requires that all “Reverent Meetings” be documented in the Project File. The “Reverent Meetings” are determined by staff members and the project manager for the project.
3. **Implemented.** CD Project Standard Due Diligence process covers tracking and documenting the performance under the Developer Agreement.

E.

**Implemented.** CD Project Standard Due Diligence process covers tracking and documenting the performance under the Developer Agreement. The Project Manager is reasonable to refer any legal issues to the County Attorney’s Office.



## **2. The Sale Of The Terra Excavating Property Was Not An "Arm's Length Transaction" And The Sales Price Was Not Properly Set.**

The purchase of the Terra Excavating parcel had issues that affected the independent sale, and the value of the parcel is questionable and was not an “Arm’s Length Transaction.” Black’s Law Dictionary defines an “Arm’s Length Transaction” as:

*Said of a transaction negotiated by unrelated parties. Each acting in his or hers own self interest; the basis for a fair market value determination. A transaction in good faith in the ordinary course of business by parties with independent interests. Black’s Law Dictionary: West Publishing Company.*

Business Dictionary further defines an “Arm’s Length Transaction” as:

*Basis of determining fair market value (FMV), it is a dealing between independent, unrelated, and well informed parties looking out for their individual interests. Transactions involving family members, and parent companies and subsidiaries, are deemed arm-in-arm dealings. To qualify as an arm's length transaction, neither of the involved parties may have any interest in the transaction's consequences to the other party.*

- A. As noted in Investigative Finding No. 1, the County Attorney's Office did not review the closing documentation and was not present at the CD loan closing. The entities in the sale had a common party. The partners for Crest Capital were Nick Kotaiche and Milmarson Development, LLC; Nick Kotaiche is Senior Vice-President for the Terra Construction Group with Terra Excavation being a subsidiary. The sale of the parcel resulted in a major financial benefit for Terra Excavating.
- B. The value of the property was established by an August 6, 2004 limited scope appraisal report requested by Terra Excavating using the "Sales Comparison Approach;" the value of the parcel was set at \$3,410,000. The appraisal was contingent on the site being contamination free and the site being completely filled, leveled and stabilized, and in compliance with all regulatory agencies and with current zoning as approved. As noted in this report, the site condition study for the proposed multi-family residential development parcel was not released until three weeks (October 29, 2004) after the closing of the Crest Capital loan (October 8, 2004). The subsurface exploration and foundation design study's preliminary finding stated:

*The site has been extensively excavated to obtain fill material and has been backfilled with construction debris for at least three decades. Substantial amounts of such debris were encountered and would present*



*a challenging situation for foundation design. A more detailed investigation would be necessary at the locations of the proposed building structures and other engineered facilities at a later date.*

Crest Capital evaluation was an additional cost of \$3 to \$4 million to fix and \$6 million to stabilize the site. To correct the problem, they would need to drill about 2,000 additional foundation supports or construct floating foundations.

No documentation was present in the Crest Capital Project file that shows what consideration was used in establishing the sales price. In addition, no documentation was present showing that consideration was given to the fact that the parcel was used as a "Type Three Landfill" (construction and demolition landfill or a special use landfill for a particular waste) and could have possible environmental risks. Terra Excavation had a permit for use as a "sand borrow pit and a construction/debris landfill." No contingency was written into the loan closing documentation to correct site deficiencies or adjust the selling price of the parcel.

The Property Appraiser's "Just Market Value" increased 104% from 2004 (\$492,700) to 2009 (\$1,094,800); however, the property sold for \$3,410,000 in 2004. The parcel value was positively affected by the actions of Terra Excavating requesting the rezoning of the parcel from A-E Agricultural to RPD-5 Residential Planned Development 5 Units per acre and the BCC approved the rezoning on April 27, 2004. Terra Excavating again requested rezoning of the parcel from RPD-5 Residential Planned to RPD-7.5 Residential Planned Development 7.5 Units per acre and the BCC approved the rezoning on July 13, 2004. After the rezoning, Terra Excavating took out a mortgage on the parcel for \$2.3 million.

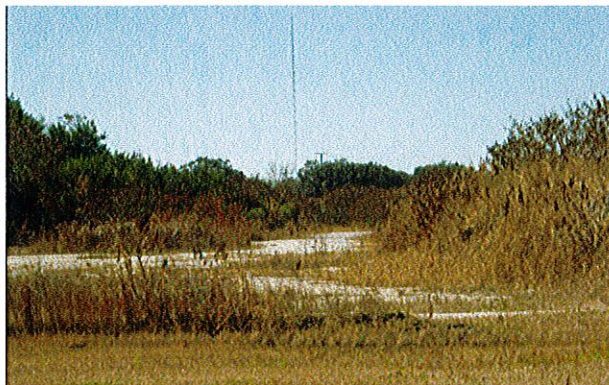
The purchase of the property from Terra Excavating to Crest Capital resulted in:

- Terra Excavating selling the parcel at an "Appraised Value" based on the ability of the parcels to support the proposed Crest Capital Project.
- Terra Excavating no longer had a liability for environmental and site condition issues by not having to clean up the site after using it as a sand borrow pit and then a construction/debris landfill.
- The restructuring of the Milmarson Place project from Terra Excavating to Crest Capital allowed Terra Excavating to financially benefit in the amount of \$3,410,000 in the transaction.

Terra Excavating ended up with no liability and no required involvement in the Crest Capital Project.



### Crest Capital Project Parcel



#### **We recommended management:**

- A. Develop a process to ensure there is a review of future transactions to determine that they are considered an "Arm's Length Transaction."
- B. When the parcel sale price is determined by a Limited Appraisal report using the Sales Comparison Approach, the established contingency stated by the appraiser must be considered in the pricing. In the case of Crest Capital, parcel issues with the site condition have a major impact on the set value of the parcel. Adequate due diligence for a commercial real estate transaction should include:
  - Proper evaluation of the property past history.
  - Environmental assessment for contamination.
  - Structure assessment of the property to support the project.
  - Evaluation that the sale is an "Arm's Length Transaction."
  - The sale value is proper.

#### **Status:**

- A. **No Longer Applicable.** CD no longer makes land loans; therefore, the independent transaction risk is no longer present.
- B. **Implemented.** CD Project Standard Due Diligence process covers the appraisal requirement.



### ***3. The Crest Capital Loan May Not Be Properly Reported To SHIP.***

The SHIP CD report obtained from the Florida Housing Coalition of November 2, 2009 for Fiscal Year 2008-2009 shows an encumbered amount of \$3,431,602.75 (Crest Capital Loan was \$3,429,126). In the Crest Capital case, the conveyance of the real property took place October 8, 2004. In our discussions with the Florida Housing Coalition, they stated that the Crest Capital Loan could only be carried as encumbered for three years or until June 30, 2007 (Fiscal Year 2007-2008 reporting period).

**We recommended** management:

Contact the Florida Housing Coalition and ensure that Pinellas County is properly reporting the SHIP Crest Capital loan.

**Status:**

**Implemented.** CD is reporting the Crest Capital LLP loan as stated by SHIP.





# DIVISION OF INSPECTOR GENERAL

KEN BURKE, CPA

CLERK OF THE CIRCUIT COURT AND COMPTROLLER  
PINELLAS COUNTY, FLORIDA

## SERVICES PROVIDED

AUDIT SERVICES

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TRAINING

GUARDIANSHIP FRAUD HOTLINE

COUNTY FRAUD HOTLINE



Accredited Office of Inspector General  
*by the Commission for Florida Law Enforcement Accreditation*

**Write:** Fraud Hotline  
Public Integrity Unit  
Division of Inspector General  
510 Bay Avenue  
Clearwater, FL 33756

**Phone:** (727) 453-3728

**Fax:** (727) 464-8386

**Internet:** [www.mypinellasclerk.org](http://www.mypinellasclerk.org)



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